

Internal Revenue Service  
**memorandum**

CC:TL-N-6963-91  
CTSanderson

date: AUG 12 1991

to: District Counsel, Chicago CC:CHI  
Attn: Joe Ferrick

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: [REDACTED]

This memorandum responds to yours dated May 8, 1991, concerning the above referenced consolidated cases. Pursuant to our instructions, you requested tax litigation advice on the issue set out below. This will confirm the previous oral correspondence on this matter between Mr. Ferrick of your office and Mr. Sanderson of this office.

ISSUE

Whether the petitioners' transactions in pork belly and gold futures should be characterized as hedges under I.R.C. § 1256(e).

CONCLUSION

The petitioners have offered to concede that the transactions in pork belly and gold futures are not hedges under I.R.C. § 1256(e) in exchange for the Service's concession of the substantial understatement penalty and the concession of an unrelated issue with respect to petitioner [REDACTED]. Because of the preference for another case presently docketed in Tax Court as the litigating vehicle on the Arkansas Best/hedging issue, and because of certain litigation hazards that we see with this case, the settlement offer of the petitioners should be immediately accepted.

FACTS

Since the case will be settled and there will be no need for briefs, we only briefly summarize the facts as we understand them. The pork belly transactions at issue were those of a joint venture, called [REDACTED], between petitioner [REDACTED] and petitioner [REDACTED]. The gold transactions were [REDACTED]'s individual trades. The petitioners allege that [REDACTED]

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was a dealer or merchant in pork bellies and its futures transactions in such commodity were hedges relating to its inventory under section 1256(e). [REDACTED] makes a similar contention concerning his gold trading. The revenue agent challenged this characterization of the petitioners' trading activities. One result of the agent's challenge is that interest expense incurred in connection with carrying the physical commodities was capitalized under section 263(g).<sup>1</sup>

[REDACTED] and [REDACTED] were consolidated for trial in [REDACTED] of [REDACTED]. The consolidated case was mostly stipulated with only [REDACTED] testifying. At the end of the trial it was discovered that losses from some other transactions of [REDACTED] s were still unresolved. Those transactions are unrelated to the trades the subject of the trial. The court suspended briefing dates on the tried issues for the parties to attempt to resolve the newly discovered unresolved issue.

The court has twice extended the time period for the parties to attempt to resolve this matter. Petitioners have offered to concede that the transactions in pork belly and gold futures are not hedges of inventory if the Service concedes the substantial understatement penalty and the unrelated [REDACTED] issue. The court has recently calendared the case for a status report on [REDACTED]. For the reasons set out below, the petitioners' offer to settle should be immediately accepted.

#### DISCUSSION

Our review of the record reveals that there are litigation hazards that a court could conclude that [REDACTED] and [REDACTED] were dealers or merchants in the commodities at issue. As such, it will be necessary for any briefs in this case to address the impact of Arkansas Best on whether as a matter of law transactions such as the futures at issue can constitute hedges under section 1256(e).

For various reasons, we would prefer another case presently docketed in Tax Court to be the first case briefed concerning the impact of Arkansas Best on the character of business hedges. (One reason for this preference is that the other case is cleaner in that it apparently will not involve the threshold factual issue in [REDACTED] of whether the transactions at issue

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<sup>1</sup>The agent also required capitalization of various expenses related to [REDACTED]'s section 1256 contract trading on grounds unrelated to the hedging issue. As we pointed out to Mr. Ferrick, the agent's position concerning the capitalization of expenses incurred in connection with section 1256 contracts appears to be incorrect and inconsistent with Service position.

are legitimate business hedges.) Taking this into account, as well as the above mentioned litigation hazards, the petitioners' settlement offer should be immediately accepted.

If you have any questions or need any further assistance, please contact Mr. Sanderson on FTS 566-3520.

MARLENE GROSS

By:

  
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